STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 98-138

September 2, 1998

MAINE PUBLIC SERVICE COMPANY
Request for Approval of Reorganization Approvals and Exemptions and For Affiliated Interest Transaction Approvals

ORDER

WELCH, Chairman; NUGENT, Commissioner

I. SUMMARY

In this Order, we grant Maine Public Service Company's (MPS) petition for reorganization approvals and exemptions, and for certain affiliated interest transactions related to the formation of a wholly-owned energy marketing affiliate, subject to conditions discussed below. We reject the request for approval that would allow the marketing subsidiary to publicize its affiliation with MPS.

II. BACKGROUND

On February 18, 1998, Maine Public Service Company (MPS) filed a petition for reorganization approvals and exemptions pursuant to 35-A M.R.S.A. § 708 and for the approval of certain affiliated transactions pursuant to 35-A M.R.S.A. § 707. As explained in its petition, MPS is seeking approval pursuant to 35-A M.R.S.A. § 708 for the formation of Energy Atlantic, LLC (EA) as a wholly-owned subsidiary from which it will be able to perform various non-core activities, such as retail and wholesale marketing of energy and capacity and the sale of energy-related products and services. MPS is also requesting the authority to invest up to $2 million in the subsidiary, which would include any loans or loan guarantees by MPS to EA. Simultaneously, MPS requests Commission approval of the following "affiliated interest" transactions pursuant to 35-A M.R.S.A. § 707:

1) MPS's making or guaranteeing unspecified loans to EA, which together with any capital contributions or investments, shall not exceed the $2 million cap requested under 35-A M.R.S.A. § 708;

2) MPS and EA entering into a limited liability company operating agreement, specifying the rights and duties of MPS as EA's sole member;

3) MPS and EA entering into a management service agreement setting forth the types of management services MPS will provide EA, how MPS shall be compensated for these services, and how costs will be allocated between the two companies; and

4) MPS and EA entering into an agreement with respect to certain intangible assets, allowing EA to promote its affiliation with MPS and providing for payment for the same.

Finally, MPS seeks an exemption from individual Commission reorganization approvals that may be triggered, under 35-A M.R.S.A. § 708), by each contribution of capital or loan by MPS to EA. MPS asks for an exemption pursuant to 35-A M.R.S.A. § 708(2)(A), provided that the total of all such loans or contributions of capital by MPS to EA shall not exceed $2 million.

On February 27, 1998, the Examiner issued a Notice of Proceeding and Opportunity for Intervention. The Public Advocate petitioned for and was granted intervention. The Public Advocate and the Advisory Staff conducted oral and written discovery regarding the MPS petition. On June 17, 1998, the Public Advocate filed written comments opposing the approval of the reorganization, primarily due to the potential financial impact on MPS and its ratepayers, and on MPS's unwillingness to accept the full financial consequences of its investment. On July 1, 1998, the Advisory Staff submitted an analysis intended to assess the financial condition and creditworthiness of MPS.

The Commission held a hearing in this matter. During the hearing, MPS presented the testimony of Calvin Deschene and Larry LaPlante in support of the reorganization. During oral argument, the Public Advocate stated that, if the financial risk of the investment were placed solely an shareholders, he would not oppose the proposed reorganization.

III. DISCUSSION

A. Statutory and Regulatory Criteria

Section 708 of Title 35-A governs reorganizations of public utilities. Section 708 states that no reorganization may be approved unless it is established by the applicant that the reorganization is consistent with the interest of the utility’s ratepayers and investors. Section 708 further states that in granting an approval, the Commission shall impose such terms, conditions or requirements that are necessary to protect ratepayers including, among other things, provisions which ensure:

- that the utility’s ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is not impaired;

- that the ability of the utility to provide safe, reasonable and adequate service is not impaired;

- that the utility’s credit is not impaired or adversely affected; and

- that reasonable limitations are imposed upon the total level of investment in non-utility businesses.

35-A M.R.S.A. § 708(2)(A). Additionally, section 713 of Title 35-A specifies that a utility may not charge its ratepayers for costs attributable to unregulated business ventures.

These statutory provisions express a legislative directive that utility diversification into unregulated businesses be approved only upon a demonstration that the utility's core activities will not be jeopardized. The concern is that investments in unregulated businesses may have negative financial consequences, such as increasing the costs of debt and equity, that could impact the utility's ability to provide service on reasonable terms. The Legislature also sought to preclude ratepayer subsidy of unregulated businesses, as well as any unfair competitive advantages that may result from an affiliation with a utility.

To implement these legislative policies and directives, the Commission recently promulgated Chapter 820, which contains rules to govern non-core activities and transactions between affiliates. In adopting these rules, the Commission reaffirmed its policy that ratepayers should be completely insulated from the financial impacts of utility investments in non-core activities. Order Provisionally Adopting Rule, Docket No. 97-886 at 16-17 (Feb. 18, 1998). To achieve this policy goal, Chapter 820 states that utilities may invest up to a specified cap without Commission review if the utility has an investment grade credit rating. A utility with a below-investment grade rating, with some exceptions, is not permitted to make an investment in a non-core activity. Chapter 820 adopts the utility’s credit rating as the standard for allowing investments because such ratings are a reliable indicator of a utility’s financial health. *Id*. at 38. If a utility is in weak financial condition, it becomes much more difficult, if not impossible, to insulate ratepayers from the financial consequences of a non-core investment. For example, an unsuccessful investment by a financially weak utility may result in a breach of a loan covenant under circumstances in which rate increases may be the only alternative to bankruptcy. The rationale underlying Chapter 820's provision is that a utility with a non-investment grade bond rating is not financially sound and, as a result, there is a reasonable likelihood that the Commission would not be able to fulfill its fundamental policy of protecting ratepayers from the consequences of non-core activities.

Chapter 820 also seeks to protect ratepayers from subsidizing non-core activities and prevent unfair competitive advantages by establishing specific affiliate transaction and accounting rules. These rules require utilities and affiliates to charge each other market rates for goods and service that are not tariffed. To the extent a market price is unavailable, Chapter 820 requires the utility to charge its affiliate based on a fully distributed cost methodology. Ch. 820 § 4.

B. MPS Financial Condition

The primary issue in this proceeding is whether the financial condition of MPS is sound enough to allow for the approval of its request to invest up to $2 million in EA. MPS is not currently rated by any of the major bond rating agencies. Therefore, MPS does not have a credit rating that would allow us to directly implement the provisions of Chapter 820 as discussed above.[1] The lack of a credit rating, however, does not alter the basic conclusion that a utility must be in sound enough financial condition to insulate ratepayers from the consequences of non-core investments. Under these circumstances, we must independently assess MPS's financial condition to determine whether to approve its investment in EA.

This matter must be scrutinized carefully because MPS has, in the recent past, endured serious financial difficulties. The Company's financial problems, due primarily to the shutdown of Maine Yankee, led to a violation of its debt covenants resulting in a significant increase in its debt costs. Additionally, the depressed level of MPS's earnings during 1997 triggered the earnings-sharing provision of its rate plan, contributing to a significantly higher rate increase in 1998 than the amount pre-established under the terms of the plan.

To assess the Company's financial condition, our Advisory Staff analyzed MPS's financial capacity by using statistical and ratio analysis to approximate a bond rating. The results of that analysis were mixed, indicating that the Company is borderline as to whether it would be of investment grade quality. For this reason, the decision of whether to approve the investment is an extremely

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[1]Chapter 820 provides that if a utility does not have a credit rating, review of the reorganization occurs pursuant to 35-A M.R.S.A. §§ 707, 708. Ch. 820, § 5(C).

difficult one. After careful consideration, we will allow MPS to proceed with its investment upon the condition, and with the complete understanding, that ratepayers will not be subject to any additional costs that may result from the investment.

To enforce this condition, we intend to scrutinize any future rate request to ensure that ratepayers are held completely harmless. MPS is under a permanent obligation to demonstrate in any rate proceeding that no part of a rate request is caused by its investment in EA.[2] If MPS cannot make such a showing, we will reduce the amount of the rate change accordingly to ensure that ratepayers have been insulated from the investment.[3] Moreover, we will not allow ratepayers to pay for any additional interest costs resulting from a debt covenant violation that is caused in whole or in part by the investment; neither will we allow an increase in rates to maintain or place the utility in compliance with its debt covenants if the violation or potential violation is a direct or indirect result of the investment.

We will also act to neutralize any impact of the investment on the Company’s cost of capital through mechanisms, described below, that establish caps on the costs of debt and equity in future rate proceedings *unless the Company demonstrates that the caps should not apply.* In essence, we adopt a rebuttable presumption that the costs of debt and equity will not be higher than the caps. For existing variable-rate debt (either long-term or short-term debt) on MPS’s books, we will use the current margin to the stated index as the maximum margin allowable regardless of the Company’s future circumstances. The reason for this is that it is common practice in negotiations regarding the breach of loan covenants for lenders to increase the margins they charge the borrower and also to impose additional fees. Currently, MPS's short-term borrowing rate (per its revolving loan agreement) has a margin of 1.375% above the applicable LIBOR Index,[4] with a provision that will reduce this margin to 1.000% when MPS meets certain financial ratio tests. In future proceedings, we will maintain this margin of 1.00% above the LIBOR index for the

[2]MPS will have both the burden of production and burden of persuasion in such proceedings.

[3]In the event that the portion of a requested rate increase attributable to the EA investment cannot be readily determined, we will approximate an amount based on any available information.

[4]MPS’s overall cost rate could go up whenever the underlying LIBOR index increases. We would confine our adjustments to the margin over the index, unless an event at EA caused the Lenders to change MPS’s underlying index to something higher than the initial (or current) index such as the Prime Rate.

Company's short-term debt for ratemaking purposes as caps on the cost of debt unless the Company can demonstrate that an increase in the margin is not related to its investment in EA.

In addition, MPS has two long-term variable rate debt issuances outstanding, one through the MPUFB and the other through the Finance Authority of Maine (FAME). These issuances have credit enhancements provided by third parties in addition to carrying variable rates. In the case of the Maine Public Utility Financing Bank (MPUFB) issuance, the enhancement is a letter of credit that has a commitment fee currently equal to 1.375% of the available amount of the letter. As with MPS's revolving short-term credit line, there is a provision in place for this fee to be reduced to 1.00% of the available letter amount when MPS meets a certain financial ratio test. The possibility of new fees and higher rates also exists with the company's fixed-rate long-term debt. We will similarly cap MPS's fixed-rate long-term debt instruments at their current embedded cost rates subject to a demonstration that a higher rate is unrelated to EA.

It is conceivable that MPS could require future debt issuances for utility purposes but be in a weakened financial condition due to some event at EA. To prevent ratepayers from being subject to this risk, MPS's future debt cost will be capped at the then current rate on investment grade utility bonds (defined as having a rating not lower than BBB- from S&P, Fitch or Duff & Phelps, or Baa3 from Moody's).

The question of segregating any cost impact of the EA investment on MPS's cost of equity is more complex. We adopt a methodology to cap the Company's cost of equity using a variation of a risk premium approach to insulate MPS's ratepayers from changes in cost of equity due to investments in EA. Rather than using Treasury or other debt instruments as the benchmark to which an equity risk premium would be added, we will use an <u>industry-specific risk premium</u> for the foreseeable future. Specifically, we will calculate both the current cost of equity for a peer group of electric utilities comparable to MPS as well as the current cost of equity for an index of water utilities to determine an appropriate premium (if any) for the electric industry today versus the water utility industry. As part of MPS's upcoming proceeding to establish transmission and distribution rates, we will determine an appropriate "electric industry" cost of equity margin for MPS. This margin would then be added to the calculated result for the same index of water utilities at a point in the future when the question may arise in order to determine a maximum possible cost of equity for MPS. The water utility industry is our benchmark in this methodology because it is not currently undergoing substantial structural change and remains largely a monopoly service. It is reasonable to compare the future T&D utility industry to the water utility industry today.[5] Therefore, the water industry appears to be a good proxy for the T&D utility industry for the foreseeable future. If future structural changes in the water industry invalidate this comparison, we will revisit this position. For the time being, however, this methodology would capture changes in the capital markets that would have an impact on "pure utilities."[6]

Additionally, our reorganization approval contains the following conditions:

- that the Commission may after providing MPS notice and an opportunity for a hearing, order that no further investment by MPS, in EA, be made upon a finding that such action is necessary to protect the public interest.[7]

- that the Commission may, after providing MPS notice and an opportunity for a hearing, order divestiture by MPS of EA upon a finding that such action is necessary to protect the public interest.

- that the Commission have reasonable access to all books, records, documents and other information relating to EA.

To conclude, we emphasize to MPS that despite its current or future financial condition, we intend to fulfill our policy of insulating ratepayers from the consequences of this investment. Therefore, if MPS decides to go ahead with the investment, it is doing so with the clear knowledge that rate relief will not be afforded if the need is a consequence of the investment.

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[5]This view of the future T&D Industry is shared by Standard & Poor's, Moody's and Fitch Investor's Service. *See* S&P's: Global Sector Review, October, 1997; Moody's: Special Comment: Future Electric Distributors; More Stable than Generators, But not Risk Free, October 1997; Fitch's: Utility Holding Companies Redeploy Capital, November 1997.

[6]In the future, a sufficient number of "pure" T&D electric utilities emerge, we may adopt methodologies that use those utilities directly, rather than our present choice of the water companies plus some margin.

[7]MPS indicated that its investment of $2 million in EA will be made in increments.

Under the conditions and requirements discussed above, we approve MPS's petition for reorganization approval to create EA and invest (through capital contributions, loans or loan guarantees) up to $2 million. As requested by MPS, we also exempt the Company, pursuant to 35-A M.R.S.A. § 708(2)(A), from any further reorganization approvals that may otherwise be triggered by each individual capital contribution or loan by MPS to EA up to $2 million.

C. Separation Requirements and Standards of Conduct

The MPS request for approval to form EA implicates the separation requirements and standards of conduct provisions of the Electric Restructuring Act.[8] In enacting this legislation, the Legislature prohibited utilities from engaging in the retail marketing of electricity, but permitted such marketing to occur through an affiliated corporation. To minimize potential market abuses and anti-competitive activities that may occur through such an affiliation, the Legislature required the Commission to establish separation requirements and standards of conduct governing the relationship between utilities and their marketing affiliates. On July 1, 1998, the Commission issued a Notice of Rulemaking, proposing such rules (Docket No. 98-457). Because the proposed rule reflects the Commission's most recent views on appropriate separation requirements, the Examiner, during the hearing on this matter, stated that it may be reasonable to apply these rules to MPS and EA pending the final adoption of the rules. Accordingly, the Examiner asked MPS to respond to the application of the proposed rules, and request and justify any exception from those rules.

On July 15, 1998, MPS responded to the Examiner's request. MPS indicated that, except for the sharing of employees prohibition, MPS and EA would comply with the provisions of the proposed rule. Pursuant to the terms of the proposed rule, MPS requested certain exemptions from the employee sharing prohibition.

The employee sharing prohibition is contained in subsection (L) of section 3 of the proposed rule. The subsection prohibits the sharing of employees among utilities and their marketing affiliates, and requires employees of the affiliate to be located in a separate building. The prohibition applies even if the employee is employed by one entity and only performs work for the other entity. The provision does allow for an exemption upon a specific finding that:

- sharing employees or facilities would be in the best interest of the public;

[8] P.L. 1997, ch. 316, "An Act to Restructure the State's Electric Industry," (codified as Chapter 32, Title 35-A).

- sharing employees or facilities would have no anti-competitive effect; and,

- the cost of any shared employees or facilities can be fully and accurately allocated between the utility and the marketing affiliate.

In its July 15 filing, MPS (on behalf of itself and EA) requested an exemption from subsection (L) for four specific activities:

1. To allow MPS to perform the management service contract;

2. To permit EA's employees, through a date no later than February 2000, to occupy a portion of the MPS office;

3. To permit MPS employees to perform accounting and human resource services; and,

4. To permit certain employees of EA to engage in wholesale sales of electricity to which MPS has an entitlement but is surplus to its needs; the arrangement would expire on February 29, 2000.

Because the proposed standards of conduct rule represent the latest articulation of our views in this area, we will require MPS, as a condition of approval, to comply with the provisions of the proposed rule pending the final adoption unless we grant specific exemptions. We address each of MPS's requests for exemption below. We will also address the proposal to allow EA to promote its affiliation with MPS.

Management Services

MPS requests an exemption from subsection (L) to allow it to perform overall management and corporate oversight, noting that the day-to-day management will be left to EA's principals. Such management and oversight would include reviewing EA's request for funding or review of any proposed major contract between EA and a potential business ally. In support of the exemption, MPS states that it would be in the public interest because allowing MPS to provide these management services will reduce the risk of EA's business failure which is in the best interest of MPS's ratepayers. MPS addresses the potential anti-competitive effect by proposing conditions intended to prevent EA from obtaining a market advantage through access to information obtained by MPS by virtue of its status as a regulated utility. Specifically, MPS proposes:

- immediate contact between EA and MPS personnel during the performance of the management service contract will be conducted by the President and/or one member of MPS's senior management, selected by the President, who will retain that function for the term of the management services contract. These individuals will maintain a log of all immediate contacts between themselves and EA personnel, and every six months will provide a copy of this log to the Commission.

- neither of these individuals will disclose to any EA employee any information obtained by MPS solely as a result of its status as a provider of core utility services unless that information is also disclosed to non-affiliated competitive electricity providers.[9]

To address cost allocation issues, all MPS employees who provide services to EA under the management service contract will keep a record of their time, which will provide a basis for monthly invoices sent to EA under the contract. MPS states that because these services are neither tariffed nor readily available in the market, it will charge EA on a fully distributed cost basis.

Chapter 820, section 4(A) governs the cost allocation of shared employees and requires that such allocation be done using a tariffed rate if available, the market rate if the tariffed rate is unavailable, or the fully distributed cost (FDC) methodology if neither a tariffed rate nor the market rate is available. MPS states that there is not a market value that can be determined for the MPS employees that will be shared with EA,[10] and therefore it must allocate the cost of shared employees between MPS and EA using the FDC methodology. It is our view that for shared employees the FDC allocation should result in a value close to the market value of such employees unless they are currently being significantly under- or over-compensated. Therefore, we will accept the FDC methodology as a proxy for the market value of shared employees.

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[9]We interpret MPS's description of the applicable information broadly to mean all information that is obtained as a result or as a consequences of MPS performing its obligations as a regulated utility. Unless otherwise indicated, we interpret language requiring disclosure to non-affiliated providers to mean the disclosure will occur simultaneously or as soon as practicable after the information is given to the affiliate. MPS uses this or similar language in other proposed conditions. Unless otherwise indicated, we interpret the language as stated in this footnote.

[10]As discussed below, MPS also proposes that accounting and human resource employees provide service to EA.

We do, however, disagree with one aspect of the Company's proposal to implement the FDC methodology. In Attachment A to the Company's July 15, 1998 letter, MPS indicates that it would apply a payroll overhead rate to the labor dollars to allocate the cost of benefits provided to MPS employees that are shared with EA.[11] MPS notes that this overhead amount would be based on MPS's total payroll dollars. We do not know how this average overhead rate would compare to the actual overhead associated with the specific employees that will be shared between MPS and EA; however, we assume there could be significant difference, depending on which individual employees are shared with EA. Therefore, we will require MPS to allocate the actual overhead costs for the individual employees shared between MPS and EA.

With this modification, we find that the provision of management services pursuant to the proposed conditions satisfies the requirement under subsection (L). Therefore, we allow the sharing of employees under the conditions and restrictions described above and in the MPS July 15 filing. Our approval is premised on the nature of the management oversight being similar to that of a board of directors, rather than that of executive management. As part of our conditions for approval, MPS is required to notify the Commission in writing as to the information provided to EA and the means by which the information was disclosed to non-affiliated providers.

<u>Sharing of MPS Office</u>

MPS requests that EA employees be allowed to conduct business from its operation center, where the majority of MPS employees are also housed. MPS states that the arrangement would be transitional until March 1, 2000; at that time, the expectation is that EA will be in a separate facility. MPS justifies the arrangement by stating that it does not require the space for its own operation and any rent will be an additional profit for MPS. Additionally, EA will begin operations with very few employees and expand over the first two years of operation; until EA is actually up and running, it is difficult to know the actual space requirements. MPS states that the transitional arrangement is in the public interest because it provides rental income to the parent and avoids

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[11]The Company also indicated that its bills to EA will include a factor to allocate a share of MPS's computer- and building-related expenses associated with providing management services to EA. However, the Company has not indicated how it will develop this factor. Therefore, we require the Company to file for approval of this factor at the time it files its accounting and human resources agreement for 35-A M.R.S.A. § 707 approval, as discussed later in this document.

economically wasteful expenditures by the subsidiary. To avoid any anti-competitive effects, MPS proposes the following restrictions:

- EA personnel shall not have access to any MPS computer facilities or equipment;

- EA personnel shall be served by a separate outside telephone line (EA calls will not go through the MPS switchboard), thereby avoiding the appearance of joint advertising or affiliate promotion by the parent;

- In order to prevent the preferential flow of market information from MPS to EA, the traffic between EA and MPS employees shall be subject to the following restrictions:

    - EA employees shall not be allowed in any MPS work area and except for their own work area, which is distinct from the rest of the operations center, EA employees shall be allowed only in non-work related areas (e.g., restrooms, corridors);

    - Any MPS employee who enters the EA work area shall log in and out and write the nature of his/her business. The log shall be available for inspection by the Commission at any time; and

    - No MPS employee shall disclose to any EA employee any information obtained by MPS solely as a result of its role as a provider of core utility services unless that information is reasonably available to all competitors on an equal basis.

Regarding cost allocation, MPS states that because a market rate for commercial space in the Presque Isle area can be determined, MPS will charge EA a monthly rental fee based upon the local market in accordance with Chapter 820, section 4(A).

We find that allowing the sharing of the MPS office for a transitional period under the conditions proposed by MPS satisfies the requirements under subsection (L). We, therefore, allow EA to be housed in the MPS operations center until March 1, 2000 under the conditions specified in the July 15 filing.

<u>Accounting/Human Resource Services</u>

MPS states that EA will not be large enough, at least during the first several years, to support its own accounting and human resource personnel, and therefore requests an exemption to allow EA to obtain these services from MPS for an indefinite period.

MPS proposes that EA employees continue, at least initially, to participate in the employee benefits package and general insurance coverage plan currently provided by MPS.[12] This continued participation allows EA to benefit from the economies of scale enjoyed by MPS's larger employee population. MPS notes that although this provides an advantage to EA, it is not an advantage related to MPS's status as a provider of regulated services. Similarly, MPS states that it would not be cost effective for EA, at least initially, to employ its own accounting staff and, because MPS would have to duplicate much of the work done by a third-party accountant, there is an economy of scale in allowing accounting services to be provided by MPS personnel.

MPS states that an exemption in these areas is in the public interest because the realization of economies of scale reduces EA's costs, and allows EA's principals to focus on business activities that should enhance EA's chances of success. Similarly, EA can realize economies by using the parent's accounting services which should avoid economic waste. To address any anti-competitive effect from the arrangements discussed above, MPS proposes to limit immediate contact between MPS and EA to a single employee of MPS's human resources department and a single member of MPS's accounting department. MPS states that like management services, human resource and accounting services are not tariffed and not readily available in local markets; therefore EA will be charged for these services on a fully distributed cost basis. For the reasons discussed above, we will accept use of the FDC methodology as a proxy for the market value of the services of shared employees.[13]

We find that allowing MPS to provide human resources and accounting services satisfies the requirements of subsection (L). We, therefore, allow MPS to provide accounting and human resource services pursuant to the conditions stated in the July 15 filing.

Sale of Excess Power

In its July 15 filing, MPS stated that until March 1, 2000 it will retain rights to the output of both its Tinker hydro facility and its Wyman 4 entitlement; the entire Wyman 4 entitlement is excess to MPS's needs, and the hydro production is excess at certain times during the year. MPS indicated that the individual most experienced in making wholesale sales of excess power, Ed Howard, will be transferred to EA immediately upon its creation. MPS proposes to

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[12]MPS is required to submit the actual contract to the Commission for approval under 35-A M.R.S.A. § 707.

[13]Consistent with our earlier discussion, we require MPS to allocate overheads associated with the specific employees, rather than using a Company-wide average.

have Mr. Howard continue to perform this function through February 29, 2000 while he is employed at EA. MPS indicated that although off-system wholesale sales have produced substantial revenues to the benefit of MPS's customers in the past, such direct benefits of these sales can no longer occur because, according to MPS, these off-system sales are non-core activities under Chapter 820(2)(C). As such, MPS claims that they must be performed by an unregulated affiliate and should not be considered a service performed for, or on behalf of MPS, but solely for EA's own account. Under this theory, the arrangement would not involve shared employees as defined in the proposed rule. MPS states that if it is incorrect and its proposal does amount to a "sharing of employees" as defined in the proposed rule, MPS asks for an exemption to allow for the arrangement.

In support of its request for an exemption, MPS states that there is a public benefit in imputing the revenues from such sales to MPS for financial reporting purposes even though they are below the line for ratemaking purposes, because such revenues will improve the Company's financial indicators. In addressing potential anti-competitive effects, MPS acknowledges that EA might conceivably have access to information that MPS has obtained by virtue as its status as a utility. To address the possible anti-competitive effects, MPS proposes the following restrictions:

- all information provided to EA by MPS will be related to and used by EA solely for the purpose of marketing excess Wyman 4 and hydro production through February 29, 2000;

- within 30 days of its formation, and every six months thereafter, MPS will inform the Commission of all information it has provided to EA pursuant to EA's performance of these excess power sales;

- by March 31, 2000, EA shall provide written notice to all NEPOOL participants that they have the right, at their own cost, to obtain copies of all information previously provided to EA by MPS that MPS obtained solely as a result of its status as a provider of regulated service; and,

- EA will limit the disclosure of any information received from MPS only to Mr. Howard and the EA employees directly involved in the marketing of MPS's surplus power. These employees shall not disclose this information to any other EA employees.

Regarding cost allocation, MPS states that, if this non-core activity is conducted only through EA, then under Chapter 820 there is no need for cost allocation. However, if the interpretation is incorrect, then under 820, section 4(E), EA services will be billed to MPS at market price.

We disagree with MPS’s underlying premise that the off-system sales of excess power from the Tinker facility and its Wyman entitlement is a non-core activity under Chapter 820 and therefore must be conducted through a separate unregulated affiliate. The sale of excess power from facilities that MPS owns to satisfy its obligations as a regulated utility is clearly not the type of activity contemplated by Chapter 820 as non-core. Although the wholesale sale is off-system and thus outside the Company’s service territory, it is so integrally related to its core activity that it cannot reasonably be separated for such purposes. Utilities are under an obligation to provide electricity to retail customers through use of the lowest cost combination of resources. Satisfying this obligation often involves purchasing and selling energy from outside the utilities' service territory, in conjunction with providing energy from utility-owned units. Viewed from this light, off-system sales of energy from utility-owned units are simply a component of the utility's core activity of providing least cost energy to its customers.[14] Additionally, MPS’s ratepayers have traditionally borne the risk of cost recovery from the Company’s generating facilities and contracts and will continue to do so through future stranded cost recovery. Therefore, the benefit of any sale of excess power must accrue to the ratepayers by accounting for these revenues above the line. We note that until retail access occurs and utilities are out of the generation services business, gray areas will exist regarding the nature of wholesale sales of electricity as core or non-core. To the extent a situation falls within the gray area, MPS should seek clarification from us.[15]

Having found that the described activity is not a non-core activity, we address whether the arrangement should be allowed. Consistent with our decision in the Central Maine Power Company's request to form a marketing affiliate, Order, Docket No. 97-930 (July 6, 1998), we will allow MPS to contract with its marketing affiliate

[14]This situation is distinguished from that in which EA buys power from the wholesale market and resells it outside MPS's service territory. Such an action would be a non-core activity.

[15]During the hearing in this matter, MPS announced that it recently entered a wholesale contract to provide power to Houlton Water Company and that it anticipates transferring the contract to EA. Because of the historical relationship of Houlton as an all requirements wholesale customer of MPS and because retail ratepayers have, at least to some degree, been at risk for lost wholesale revenue, such a transfer may not be appropriate. We will address this issue when MPS files for approval to transfer the contract.

to provide for the resale of power services.[16] To address the potential for anti-competitive impacts of the arrangement, we adopt MPS's proposed restrictions, as supplemented below. MPS proposes that EA provide notice to all NEPOOL participants that they have the right, at their own cost, to obtain copies of all information previously provided to EA. Because MPS is not in the NEPOOL control area, we require MPS to also offer to provide the information to all other competitive providers of electricity that it can identify that may do business in its area. MPS must make a reasonable effort to identify all potential providers, and offer the information to all providers licensed by the Commission. MPS will be under a continuing obligation to make the information available to new providers as they become licensed by the Commission. The obligation will continue until the Commission finds that the information has become stale and thus useless. Regarding the costs that a provider must pay to obtain the information, MPS or EA shall charge providers only the same costs that EA is charged for the same information. If providers are charged, the compensation should be paid to MPS and accounted for above the line.

Finally, because EA will be providing this service to MPS, MPS will be required to file for approval of the transaction pursuant to 35-A M.R.S.A. § 707; the filing should include a description of how the market price of the services is determined. In the event the costs to MPS of purchasing the services from EA is greater than the costs that would have occurred if Mr. Howard services were retained in-house and MPS sold the excess power itself, the difference in cost shall be borne by shareholders. MPS is under a continuing obligation to demonstrate that such cost differences are not paid by ratepayers.

<u>Use of the MPS Name</u>

In its original filing in this case, MPS proposed that EA be allowed to promote its affiliation with MPS. Such an action by EA would be prohibited under subsection (J) of the proposed rule. MPS did not address this matter in its July 15 filing, but during the hearing stated that subsection (J) would not apply because it only restricts the utility in engaging in joint advertising or marketing, not the affiliate.

We disagree with MPS. Subsection (J) of the proposed rule defines joint advertising or marketing programs to include the use of the same or substantially similar name that would require payment for goodwill under Chapter 820. MPS recognizes that the ability of EA to advertise its affiliation requires a payment for goodwill under Chapter 820, in that MPS proposed such a payment. Because the use of

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[16] In the event that retail access in Northern Maine is delayed, the Commission and the Company will need to generally re-evaluate MPS's arrangement with EA.

the MPS name as contemplated in its filing is prohibited by the proposed rule, we will not allow EA to do so pending the final adoption of the rule. Because of this finding, we need not address whether MPS's proposal for payment for goodwill is consistent with Chapter 820's policies.

D. Section 707 Affiliated Interest Transactions

As stated above, MPS seeks section 707 approval for four affiliated interest transactions. Consistent with our prior discussion and subject to the applicable conditions and restrictions stated above, we approve the following transactions:

- MPS making or guaranteeing loans to EA;
- LLC operating agreement;
- Management services agreement.

Also consistent with our prior discussion, we deny approval of the intangible asset agreement.

Accordingly, we

O R D E R

1. That the reorganization to create a wholly-owned energy marketing affiliated is hereby approved pursuant to 35-A M.R.S.A. § 708, subject to the conditions and restrictions described in the body of this Order.

2. That a capital contribution not to exceed $2 million is hereby approved pursuant to 35-A M.R.S.A. § 708, subject to the conditions and restrictions described in the body of this Order.

3. That a waiver of further reorganization approvals is hereby granted pursuant to 35-A M.R.S.A. § 708(2)(A) as described in the body of this Order.

4. That loans or loan guarantees not to exceed $2 million (inclusive of capital contributions) are hereby approved pursuant to 35-A M.R.S.A. § 707 subject to the conditions and restrictions described in the body of this Order.

5. That the LLC operating agreement is hereby approved pursuant to 35-A M.R.S.A. § 707 subject to the conditions and restrictions described in the body of this Order.

6. That the management service agreement is hereby approved pursuant to 35-A M.R.S.A. § 707 subject to the conditions and restrictions described in the body of this Order.

7. That the petition for approval of the agreement with respect to certain intangible assets is hereby denied.

Dated at Augusta, Maine this 2nd day of September, 1998.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.